STATE OF CALIFORNIA - STATE AND CONSUMER SERVICES AGENCY ARNOLD SCHWARZENEGGER, Governor

State of California Department of Consumer Affairs

LEGAL AFFAIRS
1625 NORTH MARKET BLVD., SUITE S 309
SACRAMENTO, CA 95834

Legal Guide L-6

UNDERSTANDING CONSUMER VEHICLE LEASES

October, 1998

For consumers who usually purchase motor vehicles, leasing can be difficult to understand. Many of the terms and concepts used in purchases (such as the purchase price and Annual Percentage Rate or "APR") have different names or are not present in a lease. Also, consumers may have obligations under a lease (such as fees for early termination and excess mileage) that are not present in a purchase transaction.

The goals of this Legal Guide are to explain leasing in everyday language and to help you to decide if leasing is right for you. However, this Legal Guide does not cover every aspect of leasing. For a more complete understanding of vehicle leasing, you should consult resources such as those listed on page 12.

I. HOW A VEHICLE LEASE WORKS

When you lease a motor vehicle, you do not own it. Instead, the lessor (for example, a leasing company or a bank) owns the vehicle. Your monthly payments merely entitle you to <u>use</u> the vehicle. Your payments do not build up equity (ownership) in the vehicle, as they do when you make installment loan payments in a purchase transaction. Even if you make all of the lease payments, you do not own the vehicle at the end of the lease.

Lease payments often are lower than loan payments for the same number of months on the same vehicle, and the upfront costs of a lease often are less than for a purchase. However, on identical vehicles, the total of payments under a lease often is greater than the total of loan payments made for the same period, where the vehicle is sold at the end of the period and the loan is paid off.[1]

The rest of Part I explains how motor vehicle leases work.

A. Key Lease Terms and Concepts

In order to understand how a vehicle lease works, you must be familiar with certain lease terms and concepts. The following discussion uses a three-year lease of a vehicle with an agreed-upon value of $20,000 as an example.

Lessor: The **lessor** actually owns the leased motor vehicle. The lessor usually is a bank, a company that specializes in leasing vehicles, a finance company or a manufacturer's financing arm. Usually, the lessor purchases the leased vehicle from the dealer with whom the lessee has dealt. The lessee makes his or her monthly payments to the lessor.

Lessee: The **lessee** is the person who leases the vehicle from the lessor. In this Legal Guide, "lessee" refers to a natural person (rather than a business, for example), and "you" means the lessee. The leases discussed in this Legal Guide have a term of more than four months, and cover motor vehicles that are used primarily for personal, family or household purposes.

Gross capitalized cost: The **gross capitalized cost** of a vehicle in a lease transaction is similar to the total purchase price of a vehicle in a purchase transaction (that is the negotiated purchase price, plus, for example, a service contract, sales tax and the registration fee). The gross capitalized cost includes the value of the leased vehicle as agreed upon by the lessor and lessee (called the **"agreed-upon value"** of the vehicle), and may also include one or more of the following amounts:

- License, registration, and document fees.
- An amount for a service contract, if the lessee has agreed to purchase one.

, An amount for insurance, if the lessee has agreed to purchase insurance from the lessor.

, The amount of an outstanding loan or lease balance that the lessee owes on his or her trade-in vehicle and that the lessor has agreed to pay off, if the lessee has agreed to include this amount in the gross capitalized cost.

, Other amounts that the lessee has agreed to, such as those that are listed under "Itemization of Gross Capitalized Cost" in the sample lease at page 15.

The gross capitalized cost of the leased vehicle is the grand total of the agreed-upon value of the vehicle and these other amounts when they are present in the transaction. (See example, Chart 1(a), below.) These other amounts are called **amortized amounts,** because their cost is amortized over the life of the lease (that is, the lessee pays for them over the life of the lease).

Capitalized cost reduction: A **capitalized cost reduction** is a payment in the nature of a down-payment. The capitalized cost reduction is an amount, such as a cash downpayment, a net trade-in allowance or a rebate, that reduces the gross capitalized cost.

Adjusted capitalized cost: The gross capitalized cost minus the capitalized cost reduction equals the **adjusted capitalized cost.** Chart 1(a) illustrates how the adjusted capitalized cost is calculated:

Chart 1(a): Calculation of Gross and Adjusted Capitalized Costs

Calculation of gross capitalized cost:

Agreed-upon value of vehicle:		$20,000
+Amortized amounts:		
Service contract:	$ 750	
Outstanding lease balance:	+1,250	
Total amortized amounts:	$ 2,000	+ 2,000
= Gross capitalized cost:		$22,000

Calculation of adjusted capitalized cost:

Gross capitalized cost:	$22,000
- Capitalized cost reduction:	- 1,000
= **Adjusted capitalized cost:**	$21,000

Residual value: At the beginning of the lease, the lessor predicts the value that the vehicle will have at the end of the lease. This value is called the vehicle's **residual value**. In our example, assume that the lessor predicts the vehicle's residual value after three years will be $9,000.

Vehicle depreciation: A vehicle's **depreciation** is the amount of value that the vehicle loses over a period of time. At the beginning of the lease, the lessor calculates the vehicle's depreciation over the life of the lease by subtracting the vehicle's residual value from the adjusted capitalized cost.

The calculation of depreciation looks like this:

Chart 1(b): Residual Value and Depreciation

Adjusted capitalized cost:	$21,000
- Residual value:	- 9,000
= **Depreciation**:	$12,000

In our example, the $21,000 adjusted capitalized cost includes $2,000 of amortized amounts (see Chart 1(a)). Therefore, the $12,000 depreciation amount also includes the amortized amounts. The lessee in this example would be obligated to pay the lessor the $12,000 in depreciation and amortized amounts, together with a rent charge (see next section), over the life of the lease.

B. How the Lessor Calculates The Monthly Lease Payment

When you lease a vehicle, you pay the lessor for all of the following:

, The vehicle's depreciation over the life of the lease, plus

, The amortized amounts that you have agreed to include in the gross capitalized cost, such as the service contract and the outstanding lease balance in Chart 1(a), plus

, A **rent charge**, which is an amount that the lessor charges in addition to the depreciation and the amortized amounts.

In our example, the total of depreciation and amortized amounts is $12,000. Assume that the rent charge is $4,000. This means that you will pay the lessor a total of $16,000 for depreciation and the amortized amounts, plus the rent charge, over the three-year life of the lease. The total of the depreciation, amortized amounts and rent charge over the life of the lease is called the **total of base monthly payments.**

The total of base monthly payments is calculated like this:

Chart 1(c): Total of Base Monthly Payments

Depreciation/amortized amts:	$12,000
+ Rent charge:	+ 4,000
= **Total monthly payments:**	$16,000 (excluding sales/use tax)

In order to calculate the monthly payment amount on a leased vehicle, the lessor takes the total of the depreciation, the amortized amounts and the rent charge and divides it by the number of months in the lease. In our example, the calculation is shown in Chart 1(d) in the right-hand column:

Chart 1(d): Monthly Payment

Total base monthly payments:	$16,000
÷ 36 months:	÷ 36
= Base monthly lease payment:	$ 444 (plus sales/use tax)

The base monthly lease payment does not include sales or use tax, but the lessor collects this tax each month. Assuming a local tax rate of 7.75 percent, your total monthly payment in this example will be $478 ($444 x .0775 = $34; $444 + 34 = 478).

Federal law now requires lessors to disclose the calculation of the monthly payment amount using a mathematical progression similar to Charts 1(a) - 1(d).[2] Using our example, the monthly payment portion of the federal model lease form looks like this:

Federal Consumer Leasing Act Model Disclosure

[See pages 15-16 for the entire federal model lease form]

Your monthly payment is determined as shown below:

Gross capitalized cost. The agreed upon value of the vehicle ($ 20,000) and any items you pay over the lease term (such as service contracts, insurance, and any outstanding prior credit or lease balance)	$	22,000
Capitalized cost reduction. The amount of any net trade-in allowance, rebate, noncash credit, or cash you pay that reduces the gross capitalized cost	-	1, 000
Adjusted capitalized cost. The amount used in calculating your base monthly payment	=	21,000
Residual value. The value of the vehicle at the end of the lease used in calculating your base monthly payment	-	9,000
Depreciation and any amortized amounts. The amount charged for the vehicle's decline in value through normal use and for other items paid over the lease term	=	12,000
Rent charge. The amount charged in addition to the depreciation and any amortized amounts	+	4,000
Total of base monthly payments. The depreciation and any amortized amounts plus the rent charge	=	16,000
Lease term. The number of months in your lease	÷	36
Base monthly payment	=	444
Monthly sales/use tax	+	34
	+	
Total monthly payment	=$	478

C. How the Lessor Applies Each Monthly Lease Payment

The total of the monthly payments in our example ($16,000) is composed of the depreciation amount and the amortized amounts, plus the rent charge. This means that each monthly lease payment pays off some of the depreciation/amortized amounts and some of the rent charge until the total amount is paid off at the end of the lease.

The total amount of each monthly lease payment is the same, but the lessor applies different portions of each payment to (1) the rent charge and (2) the depreciation/amortized amounts. The portion of each monthly payment that the lessor credits to the rent charge and to the deprecation/amortized amounts depends on the number of monthly payments that have been made. As each payment is made, the portion that is applied to the rent charge decreases slightly and the amount that is applied to the depreciation/amortized amounts increases slightly. (See example, Chart 6, page 14.)

You can see that the concept behind a lease is very different from the concept behind the purchase of a vehicle that is financed by a loan (a "financed purchase"). Under a lease, the lessee pays for the vehicle's depreciation for the term of the lease, together with any amortized amounts, plus the rent charge. Under a financed purchase, the buyer pays for the vehicle, by repaying the portion of the purchase price that is financed, plus interest. That is why monthly lease payments often are lower than monthly loan payments. However, unlike the lessee, the purchaser will own the car when he or she has paid off the loan.

D.
The Lessee's End-of-Lease Obligations

Today, most consumer vehicle leases are **"closed-end"** leases.

In a closed-end lease, the lessee pays a fixed payment for a fixed number of months. At the end of the lease term, when all of the payments have been made, the lessee returns the vehicle to the lessor. The lessee typically must pay the lessor a reasonable disposition fee, but does not owe the lessor anything more unless the vehicle has been damaged, has not been serviced or cared for as required by the lease, or has been driven more miles than allowed by the lease. Lessors sometimes call closed-end leases "walk-away" leases for this reason.

Almost all consumer leases set limits on mileage and vehicle wear and tear during the life of the lease. It is important that you understand these limits before you agree to lease a vehicle because charges for excess mileage and wear and tear can increase your end-of-term lease costs. Sometimes, these charges can be quite high.

The lessor's beginning-of-lease prediction of the vehicle's end-of-lease residual value assumes that the vehicle will be returned in reasonably good condition when the lease ends. The mileage and wear and tear limits are built into the lease to help assure that the lessor's prediction of the residual value (to the extent that it is based on the condition of the vehicle) will be fairly accurate at the end of the lease.

Most vehicle leases allow the vehicle to be driven 12,000-15,000 miles a year for each year of the lease. However, some leases allow only 10,000 miles each year. Most leases require the lessee to pay from $.08-.15 for each extra mile, but some leases charge as high as $.25-.30 per extra mile.

Vehicle wear and tear standards can be quite stiff. For example, some current leases consider unmatched tires and stains or worn areas in the interior to be excess wear and tear. (See pages 9-10 for more examples.)

Additional Explanation:
"Closed-End" and "Open-End" Leases

In a **closed-end lease,** once the lessor has estimated the vehicle's end-of-lease residual value, the lessor is bound by that estimate. Even if the vehicle depreciates more than expected during the life of the lease, the lessor is bound by its original estimate of the vehicle's residual value. Thus, the lessor is said to bear the risk of the vehicle's depreciation in a closed-end lease.

"Open-end" vehicle leases were quite common until the tax laws were changed several years ago. Under an open-end lease, the lessor would estimate the vehicle's end-of-lease residual value, but would not be bound by that estimate. If the vehicle depreciated more than expected during the life of the lease, the lessee would owe the lessor the difference between the estimated residual value and the vehicle's actual value at the end of the lease. Thus, under an open-end lease, the lessee would bear the risk of the vehicle's depreciation. Generally at the end of an open-end lease, the lessee could not be liable to the lessor for more than three times the monthly payment amount, plus any damage, excessive mileage, and missed payments.[3]

E.
SAMPLE LEASE FORM

Pages 15-16 provide a sample closed-end vehicle lease contract that has been completed to show the following transaction:[4]

- Term of lease: 36 months
- Agreed-upon value of vehicle: $19,514
- Gross capitalized cost of vehicle: $19,514
- Capitalized cost reduction: $0
- Residual value of vehicle: $9,013
- Depreciation: $10,501
- Rent charge: $3,544
- Monthly payment: $390
- Initial Payment: $1,165

, Disposition fee: $250

This lease transaction is the example used in Part II.

II.
SOME ADVANTAGES AND DISADVANTAGES OF LEASING

Leasing has some features, such as lower monthly payments, which many consumers consider to be true benefits. However, many consumers consider other features of leasing, such as fees for early termination and excess wear and tear, to be significant disadvantages. Part II discusses some of the advantages and disadvantages of leasing.

A.
Advantages of Leasing

1. Upfront fees

The upfront fees under a lease usually are less than in a purchase transaction.

At the beginning of a lease, you generally are required to pay an "initial payment," which may include the first month's lease payment, a security deposit equal to one or two months' payments, a lease acquisition fee, and the costs of the title and the first year's registration.

Some leases also require the lessee to pay a capitalized cost reduction (see page 2). The capitalized cost reduction may be as much as 10% or more of the capitalized cost. Paying the capitalized cost reduction and/or the initial payment makes the monthly payments lower than if one or both of these amounts were not paid.

By contrast, in order to obtain a loan to purchase a new vehicle, the purchaser may have to pay a down-payment of up to 20% of the total of the purchase price, the sales tax and the first year's registration. However, in today's competitive market, some lenders offer loans that require no downpayment, or a 10% downpayment.

Some leases today offer an attractive monthly payment, but require an initial payment or capitalized cost reduction that is nearly as large as a down-payment in a typical purchase transaction. Making such a large upfront payment in a lease undercuts one of the main arguments in favor of leasing.

2. Monthly payments

Monthly payments under a lease usually are less than under a loan for the purchase of the same vehicle. This is because a lessee pays for the vehicle's depreciation, a rent charge and any amortized amounts (see page 2), while a purchaser repays the entire amount borrowed to purchase the vehicle, plus interest.

3. Sales and use tax

From a tax perspective, consumer lessees and purchasers of vehicles now are on the same footing. For years, one of the advantages of purchasing a vehicle was that the consumer could deduct the interest and taxes, but this is no longer true.

4. Early purchase option

Until recently, California leases did not always allow the lessee to purchase the leased vehicle before the end of the lease. Leases which did allow early purchase often required the lessee to pay an early termination fee (see discussion, pages 6-8) in addition to the purchase price. California law now gives lessees the right to purchase the leased vehicle or trade it in before the end of the lease, and sets a method for determining the purchase price.[5] Chart 5 (page 13) shows a calculation of an early purchase/ trade-in price under the new California law.

5. End of lease

Under a closed-end lease (see page 4), you can return the vehicle to the lessor upon making the final lease payment, pay the reasonable disposition fee stated in the lease and any charges for excess miles and wear and tear, and walk away from the vehicle. Many consumers consider this to be a major advantage of a lease, because it avoids "the trade-in hassle" often experienced by purchasers when they trade in their vehicles.

However, recent articles point out that lessees often disagree with the charges assessed by the lessor at the end of the lease (for example, for excess wear and extra miles), and may wind up negotiating with the lessor over these amounts.[6] To many consumers, this may offset any benefit of avoiding the trade-in hassle.

Some lessees, whose leases contain a purchase option, consider it advantageous to be able to decide whether or not to purchase the vehicle at the end of the lease, after they have lived with the vehicle for several years. The purchase option price may be the vehicle's residual value, another price stated in the lease, or a price based on the vehicle's end-of-lease Blue Book value (or the value set by a similar readily-available publication), plus a fee charged by the lessor.

At the end of the lease, if you have complied with all of the lease terms, the security deposit that you paid at the beginning of the lease will be returned to you, or will be credited against amounts that you may owe for excess miles and wear and tear. If you exercise a purchase option, your security deposit will be credited against the purchase price.

6. Warranty coverage

Today, consumer lessees of new motor vehicles enjoy the same warranty and Lemon Law protections as do purchasers.[7]

7. Intangible advantages

Some people simply prefer leasing over purchasing for personal reasons. For example, some people like to have a new car every two-three years, or may prefer to always drive a car that is under factory warranty. Some people like to have "the most car" possible for the amount of monthly payment that they can make. Some people want to avoid the "trade-in hassle." Leasing makes sense for these people, as long as they drive an average amount of miles each year (for example, 15,000 miles or less) and take good care of their cars.

B.
Some Disadvantages of Leasing

1. Overall expense

A major disadvantage of leasing a vehicle is that the overall cost often is more than purchasing the same vehicle.[8] Many automotive finance experts believe that the cheapest way to pay for the use of a vehicle is to buy the vehicle for cash and keep it for its useful life (today, often 100,000 miles or more).[9] These experts believe that the next cheapest way is to make the largest downpayment on the shortest-term loan that you can afford and keep the vehicle for its useful life.

Not surprisingly, most consumers cannot pay cash for a vehicle, and many do not want to keep a vehicle for 100,000 miles. For the average consumer, purchasing a vehicle, selling it after several years and paying off the loan usually is cheaper than leasing the same vehicle and paying all the lease payments.[10] However, some automotive finance experts consider that the costs of these two transactions are "competitive."

2. Early termination fees

Probably the biggest disadvantage of leasing a vehicle is the cost of terminating (ending) the lease early. An "early termination fee" can be as high as several thousand dollars.

Most consumers do not understand how large early termination fees can be or their liability for these fees if the lease ends early for almost any reason. If you are thinking about leasing a vehicle, you need to understand when early termination fees can be assessed and how much they can be, even if you are certain that you will keep the vehicle for the life of the lease. Your potential liability for early termination fees should be a major consideration, since more than 50% of all consumer leases in California are terminated early by the lessee or the lessor.

You typically are required to pay an early termination fee when your lease ends early for any reason, including your defaulting or ending the lease voluntarily. Also, you may be required to pay at least part of the early termination fee if the vehicle is stolen or damaged before the lease ends and is declared a total loss by the insurer (see discussion of "GAP liability," page 9).

For the reasons explained in the rest of this section, early termination fees usually are <u>very</u> hefty. The new federal regulations that govern consumer vehicle leases emphasize this by requiring that the following notice be placed in all vehicle leases:

"Early Termination. You [the lessee] may have to pay a substantial charge if you end this lease early. <u>The charge may be up to several thousand dollars</u>. The actual charge will depend on when the lease is terminated. The earlier you end the lease, the greater this charge is likely to be."[11]

a. <u>Calculation of early termination fees</u>

In calculating the terms of the lease and the lessee's obligations, the lessor assumes that the lease will continue in effect for the entire lease period (for example, 36 months). The lease is structured so that you will pay the lessor all of the vehicle's estimated depreciation, the full rent charge and any amortized amounts that you have agreed to (see pages 1-2) over the period stated in the lease. If the lease ends early, you will not have paid all of these amounts to the lessor.

To compensate the lessor when the lease ends early, California law allows the lessor to require you to pay a portion of the adjusted capitalized cost as a fee.[12] You must pay the lessor the vehicle's adjusted capitalized cost (page 2), minus the sum of the L realized value of the vehicle (often, the vehicle's wholesale value) plus all of the depreciation and amortized amounts accrued through the date of early termination. You also must pay the lessor any delinquent and unpaid payments and a reasonable disposition fee, if one is stated in the lease.

Chart 2 shows how the early termination fee is calculated. Chart 3 below gives examples of early termination fees at 12 and 18 months for the lease transaction described at I.E. (pages 4-5) and the sample lease at pages 15-16.

Chart 2: Calculation of Early Termination Fee

Adjusted capitalized cost
+Delinquent and unpaid payments (excluding excess wear & mileage charges)
+ Reasonable disposition fee (if stated in lease)
- [All depreciation and amortized amounts accrued + the realized value of the vehicle]
= Early termination fee

Chart 3: Examples of Early Termination Fees

Month of Lease	**Adjusted Capitalized Cost**	**Depreciation Paid***	+	**Realized Value****	**Equals**	**Early Termination Fee**
12	$19,515	$3,963	+	$12,260	= $16,223	$19,515 - 16,233 = **$3,292**
18	$19,515	$6,007	+	$11,365	= $17,372	$19,515 - 17,372 = **$2,143**

* Chart 6, page 14, explains how the depreciation amounts were calculated.
** Realized value taken or derived from Edmund's Automobile Buyer's Guides (March, 1998).

Early termination is expensive. As shown by Chart 3, early termination is more expensive early in the lease because the car depreciates more rapidly early in the lease, and because you will have paid less of the scheduled depreciation and amortized amounts. This means that a smaller amount is subtracted from the adjusted capitalized cost when the lessor calculates the early termination fee.

Later in the lease, by contrast, you will have paid more of the scheduled depreciation and amortized amounts, and a larger amount therefore will be subtracted from the adjusted capitalized cost when the lessor calculates the early termination fee.

You would be required to pay the early termination fee in Chart 3 in addition to the monthly lease payments that you already have made. If you terminated the lease after 18 months, for example, your total payments on the $19,515 car would be $9,788[13] -- and you would not have the car.

In addition to the fees in Chart 3, you would also have to pay a reasonable disposition fee if one is stated in the lease contract, plus any delinquent payments (but not excess mileage and wear charges). If you have defaulted, you would also have to pay the lessor's reasonable costs for repossessing, storing and reconditioning the vehicle, if the lessor has paid these costs.

Additional Explanations:

Determining the Vehicle's Realized Value at Early Termination

California law provides that the vehicle's realized value at early termination may be determined by one of the following methods:

, By appraisal (at the lessee's election and expense), or

, By the higher of the price paid for the vehicle at disposition or any other amount established by the lessor or the lease contract, or

, By reference to a recognized used vehicle value guide, such as the Kelley Blue Book Auto Market Report. (The lessor can use this last method only if the lessor intends to keep the vehicle or to lease it to someone else.)

If the vehicle is a total loss as a result of theft or damage, and if the lessee has insurance on it as required in the lease, the realized value is the amount of the deductible plus the insurance settlement proceeds (or a higher amount agreed to by the holder of the contract).[14]

Effect of Higher Residual Value on Early Termination Fee

A higher residual value has the effect of increasing the rent charge. This means that more of each monthly payment goes to the rent charge and less goes to depreciation than with a lower residual value. As a result, at early termination, the lessee will have paid less depreciation and the early termination fee will be higher. On the other hand, a higher residual value lowers the monthly payment amount.

b. Lessor's notice; disposition of vehicle

In order to be entitled to any early termination fee, the lessor must send the lessee a written notice regarding disposition of the vehicle.

Often, the lessor sells the vehicle to establish its realized value (see Charts 2 and 3 above). The lessor must act in good faith and in a commercially reasonable manner in connection with the disposition of the vehicle.[15] As a general rule, the lessee is not liable for any early termination fee if the lessor has not complied with these notice and good faith requirements.[16]

Additional Explanation:

Contents of Lessor's Notice of Disposition

The lessor's written notice of disposition must be given to the lessor at least 10 days before the lessor disposes of the vehicle or determines its value. The notice must do all of the following:

, Itemize the lessee's early termination liability and state the highest early termination fee for which the lessee can be held liable.

, Explain how the vehicle's realized value will be determined, including by appraisal, wholesale value, or the higher of the price paid upon disposition or another amount established by the lessor or in the lease contract.

, Explain the lessee's right to have the vehicle appraised (at the lessee's election and expense) to set its realized value, and the procedures for obtaining an appraisal.[17]

These notice requirements do not apply when the insurer declares the vehicle a total loss as a result of theft or damage and the lessee has insurance on the vehicle as required by the lease.[18]

c. Lessons for consumers

Many lessees do not understand how large the early termination fee can be until they are faced with having to pay it. There are several possible explanations for this:

, The lease contract language that explains early termination fees usually is very complicated.

, Some salespeople represent that it is easy to end the lease early for any reason, and either do not mention the early termination fee or represent that it is small.

, Lessees, in their excitement about getting a new car, simply don't care about potential early termination liability.

In the past, some lessees who were faced with large and unexpected early termination fees tried to avoid having to pay them by re-leasing or "subleasing" their vehicles to someone else. Today, subleasing without the consent of the lessor is illegal in California.[19]

While early termination fees have taken many consumers unawares, you can learn from their mistakes and take precautions to reduce your risk of having to pay such a fee. For example:

, Before you enter into a lease, be certain that you will keep the vehicle for the entire lease period.

, If you think that you may not keep, or be able to keep, the vehicle for the entire lease period, choose a shorter lease. Do not rely on the right to terminate the lease early.

, Be sure that you understand as much as you can about your liability if the lease ends early for any reason. There will always be charges in addition to the "termination" or "disposition" fee stated in the lease (typically, $200-250). If you do not understand the lease provisions on early termination, ask the dealer or lessor for written examples of the early termination fees if you terminate the lease, for example, after 12 and 24 months.

Although early termination is expensive, there are occasions when a lessee has no choice but to end the lease early (for example, because of significant loss of income or unexpected major medical expenses). Recognizing this, California law now gives the lessee the right to terminate the lease at any time, subject to payment of the early termination fee.[20]

Also, California law now gives the lessee the right to purchase the vehicle or trade it in before the lease ends. To do so, the lessee must pay the difference between the adjusted capitalized cost and the sum of all depreciation and amortized amounts that have accrued, plus any delinquent payments and a reasonable purchase option fee (if one is stated in the lease). (See Chart 5, page 13, for an example.)[21]

3. "GAP" liability

If your leased vehicle is stolen or damaged before the end of the lease, and is declared a total loss by the insurance company, there may be a difference (a "gap") between the fee on termination and the proceeds of your insurance plus your deductible amount. Some leases hold the lessee liable for the gap amount.

Chart 4 shows how gap liability is calculated on early termination when the vehicle has been declared a total loss by the insurance company.

Chart 4: Calculation of Gap Liability

Adjusted capitalized cost
+ Delinquent and unpaid payments (excluding excess wear & mileage charges)
+ Reasonable disposition fee (if stated in lease)
- [All depreciation and amortized amounts accrued + insurance proceeds + deductible amount]

= Gap amount owed

If your lease obligates you to pay the gap amount, the lease must contain a statutorily-prescribed "GAP liability notice" on the first page.[22]

Some lessors sell "gap" protection coverage (often called "guaranteed automobile protection coverage"). A lessee may purchase this coverage, for an additional fee, to cover the lessee's potential gap liability.

4. Insurance

Both lessees and purchasers are required to carry insurance on their vehicles, but lessors typically require higher minimum limits than lenders require. Essentially, the lessor requires these higher limits so that its asset (the leased vehicle) is protected.[23]

5. Extra miles

Lease contracts set a mileage limitation for the life of the lease -- typically 15,000 miles a year or 60,000 miles total. However, some leases set much lower mileage limits -- as low as 10,000-12,000 miles a year. If you drive the vehicle more than the total number of miles allowed, you will have to pay for the extra miles. The charge for extra miles may be $.08-.15 per mile, and perhaps as high as $.25-.30 per mile.

If you drive the leased vehicle more than the total number of miles allowed, the charge for excess mileage can substantially increase your end-of-lease costs.

Some lease contracts allow the lessee to purchase "extra miles" at the beginning of the lease for a set amount. If you think it is likely that you will drive more miles than are allowed by the lease, purchasing extra miles at the beginning of the lease may be a good idea. However, you should understand that if you do not use the extra miles, you probably will not get a refund for them.

6. Excess wear and tear

In addition to mileage limits, vehicle leases contain wear and tear standards. These standards are designed to minimize the amount of reconditioning that the vehicle will need at the end of the lease before the lessor can sell or lease the vehicle to someone else.

Before you agree to lease a vehicle, you should carefully check the wear and tear standards in the proposed lease contract. Sometimes, these standards can be quite stiff. For example, some current leases consider the following to be excess wear and tear:

- Unmatched tires, tires with less than 1/8 inch of tread, or less than a full set of tires (including a spare of the type originally supplied with the vehicle).
- Chipped glass or mismatched or miscolored paint.
- Electrical or mechanical defects or malfunctions.
- Burned out lights.
- Missing trim.
- Stains or worn areas in the interior.
- Damage from equipment or signs removed from the vehicle.

One lease requires that any replaced sheet metal be original equipment manufacturer sheet metal, and that all other repairs be made with original equipment manufacturer parts or parts of equal quality.

If you return your leased vehicle at the end of the lease, and if it does not meet the wear and tear standards stated in the lease, you can expect the lessor to charge you for the repairs to bring the vehicle up to those standards. One leasing expert suggests that consumers who are considering leasing should assume (and factor into their decision) that they will be asked to pay roughly twice the amount of their security deposit to cover excess mileage and wear and tear charges at the end of the lease.[24]

7. No Equity

A key factor for many consumers in deciding whether to lease a vehicle is that the lessee never has an ownership interest in the vehicle unless he or she purchases it (for example, using an end-of-lease purchase option).

In a lease, the lessee's monthly payments only reduce the total amount owed under the lease, and do not build equity (ownership) in the vehicle. By contrast, in a purchase transaction, the purchaser builds up equity in the vehicle with each installment payment until he or she owns the vehicle when the final installment is paid. Moreover, the purchaser can pay off the loan at almost any time, usually without a prepayment penalty and perhaps with a refund of unearned finance charges, and own the vehicle outright.

8. Unfamiliar terms and concepts

The terms, concepts and calculations in lease transactions are more complex than in purchase transactions, and the federal and California leasing laws do not always aid consumers' understanding of them.

Recent changes in federal and California law require many more disclosures than under prior law. For example, prior law generally did not require that the vehicle's "initial value" be disclosed; the law now requires that the vehicle's agreed-upon value at the beginning of the lease be disclosed as part of the gross capitalized cost (see pages 2, 15).

Even so, many of the terms used in lease transactions are different than those used in purchase transactions. For example, the terms "purchase price" and "downpayment" are not used in lease transactions. This can be confusing to a person who is not familiar with the concepts and language of leasing, and may make negotiating favorable lease terms more difficult. The changes in federal law have attempted to make lease terminology more understandable. (See pages 15-16 for a sample of the model federal lease form.)

One disclosure that the new laws do not require is the "lease rate" or "money factor." The money factor, as it is commonly called, is a cost of financing the transaction and is akin to interest paid on a loan in a financed purchase. In a loan, the interest rate (called the "annual percentage rate" or the "APR") must be disclosed. The money factor is used to calculate the rent charge (typically, the lessor's profit) and the lessee's liability if the lease ends early.

While lessors are not required to make this disclosure, some lessors will tell you their money factor if you ask while discussing proposed lease terms. The money factor in a lease transaction typically is expressed as a decimal fraction, rather than as the familiar percentage rate in a purchase transaction. For example, the money factor in the lease transaction described at I.E. (pages 4-5) is .00345. As a general (but not foolproof) rule of thumb, multiplying the lease rate by 2400 gives you a rough equivalent of the interest rate (here, .00345 x 2400 = 8.28 percent).[25] Generally, the lower the money factor, the less the rent charge will be.

Knowing the money factor can help a person who is trying to decide between leasing or purchasing a vehicle, and can make comparing costs and terms among lessors easier for a person who has decided to lease a vehicle. Knowing the money factor also can help a lessee figure out his or her early termination liability under the lease (see pages 6-8).

III.
OVERVIEW OF LESSEES' LEGAL RIGHTS

Both California and federal law govern consumer leases of motor vehicles in this state.[26]

Federal Regulation M[27] requires that the lessor disclose most of the terms of the lease in the lease contract, and prescribes the format for some of the key disclosures.[28]

Regulation M also contains a model lease contract that most lessors follow. See pages 15-16 for a sample of this contract that reflects the lease transaction described at I.E. (pages 4-5).

The lessor cannot require you to sign a lease contract if it has any blank spaces to be filled in.[29] The lease contract must be signed by both you and the lessor, or the lessor's authorized representative.[30] The lessor must give you an exact copy of the completed lease contract when both you and the lessor have signed it, and cannot deliver the vehicle to you until this has been done.[31] The lessor also should give you a copy of any credit statement and any purchase order which you have been required or requested to sign during the contract negotiations.[32]

Contrary to most consumers' belief, there is no "cooling off" period or other cancellation period for vehicle leases. However, a lease can be canceled with the lessor's agreement, or for legal cause, such as fraud.[33]

If you pay part of the amount due at lease signing or delivery with a net trade-in allowance, the lease contract must state a brief description of the trade-in vehicle and its agreed-upon value. The same is true if the lease's "Itemization of Gross Capitalized Cost" includes any outstanding balance from a trade-in.[34]

If for some reason you or the lessor do not sign the lease contract, the lessor generally must return to you any prepayment that you have made.[35] Also, if your credit application is not approved, you have the right to return the leased vehicle and to receive a refund of any payments that you have made (unless the non-approval results from an incomplete application, or from your supplying incorrect information).[36]

Sometimes, a lessee leaves his or her vehicle with the lessor as a downpayment, but the lessor breaches the lease and fails to return the lessee's vehicle. In this situation, the lessee can recover from the lessor either the fair market value of the lessee's vehicle or its value stated in the lease contract, whichever is greater. The lessor must tender (offer) the lessee the appropriate amount within five days after the breach.[37]

If the lessor wilfully fails to comply with any of the required lease disclosures, the lessee can rescind (cancel) the lease contract.[38] If the lessor has made a mistake in the lease contract, and if correcting the mistake will increase the amount of the contract balance, the lessee can rescind the lease, unless the lessor waives (gives up) the collection of the increased amount.[39]

Instead of rescinding a contract that does not comply with the lease disclosure requirements, the lessee can bring a lawsuit to recover actual damages, statutory damages, the costs of the action, and reasonable attorney's fees as determined by the court.[40] If the lessor has violated the federal Consumer Leasing Act or federal Regulation M, the lessee can bring a lawsuit to recover actual damages, statutory damages, the costs of the action and reasonable attorney's fees as determined by the court.[41] A lessee generally cannot bring similar actions based on the same facts in both federal and state courts.[42]

While lessees have these rights under the law, it is best not to get into a situation where you will need to rely on them. Before you sign a lease contract, be sure that:

, The agreed-upon terms of the transaction are stated accurately in the lease contract;

, All the spaces in the lease contract that apply to your transaction have been filled in;

, You agree with and understand all of your obligations under the lease contract (for example, early termination liability and excess wear standards and mileage limitations); and

, A brief description of your trade-in vehicle, its agreed-upon value, and any outstanding loan or lease balance are stated accurately in the lease contract (if you are trading in your present vehicle).

Get copies of any credit statement or purchase order that has been filled out during the negotiations. Be sure that you get an exact copy of the lease contract which has been signed by all parties, and do not accept delivery of the motor vehicle until you have received such a copy.

IV.
OTHER RESOURCES ON CONSUMER VEHICLE LEASES

Keys to Vehicle Leasing: A Consumer's Guide, Federal Reserve Board, www.bog.frb.fed.us, or request this title ($.50 cost) from Consumer Information Center, Department 304E, Pueblo, CO 81009

Auto Leasing Supplement, LA Times, Feb. 16, 1998

Should You Lease Your Next Car? Consumer Reports, Dec., 1997

"Consumer Leasing Act" in *Truth in Lending* National Consumer Law Center, Boston (3rd ed. 1995 and 1997 Cumulative Supplement)

Official Staff Commentary on Regulation M, Federal Reserve Board, 12 Code of Federal Regulations Part 213, Supp. I.

*****

Prepared by: John C. Lamb, Senior Staff Counsel, Legal Services Unit, October, 1998

NOTICE: We attempt to make our Legal Guides accurate as of the date of publication, but they are only guidelines and not definitive statements of the law. Questions about the law's application to particular cases should be directed to a specialist.

This document is available on the Internet. See the Department of Consumer Affairs' homepage at www.dca.ca.gov.

ENDNOTES

1. See "Should You Lease Your Next Car?" Consumer Reports, December 1997 (cost comparisons for leasing and purchasing 25 popular vehicles).

2. 12 Code of Federal Regulations Section 213.4(f).

3. California Civil Code Section 2988(b); 12 Code of Federal Regulations Section 213.4(m)(2).

4. Derived from "Lease or buy" table of comparisons in "Should You Lease Your Next Car?" Consumer Reports, December 1997. Assumptions: Example excludes sales tax and registration fees. Monthly payment amount is rounded. Initial lease payment includes no capitalized cost reduction. Lease allows 15,000 miles per year. Residual value estimated at 44.21%.

5. California Civil Code section 2987(f). This section sets the maximum selling price of the leased vehicle at early purchase/trade-in (excluding taxes and other charges incidental to the sale). Payment of this price relieves the lessee of any further liability under the lease contract. (See example, Chart 5, page 13.)

6. For example, "Money Talk," Los Angeles Times, March 2, 1997; "Should You Lease Your Next Car?" Consumer Reports, December 1997.

7. See California Civil Code section 1795.4.

8. "Auto Leasing: Is It Good for Consumers?" in At Home With Consumers, Direct Selling Education Foundation, December, 1996.

9. For example, "Should You Lease Your Next Car?" Consumer Reports, December 1997. One expert points out, that with the expected life of vehicles today, a consumer could purchase the vehicle, pay off the loan at the end of three, four or even five years, and be able to drive the vehicle for several more years without making monthly payments. ("Auto Leasing: Is It Good for Consumers?" in At Home With Consumers, Direct Selling Education Foundation, December, 1996.)

10. See "Should You Lease Your Next Car?" Consumer Reports, December 1997.

11. 12 Code of Federal Regulations Section 213.4(g)(2). Emphasis in original.

12. California Civil Code Section 2987.

13. You would have made 18 payments at $390 = $7,020. You would pay this plus the early termination fee of $2,143. You would have already paid a $375 lease acquisition fee and you would be required to pay a $250 end of lease fee. The total is $9,788. Your $400 security deposit would be credited against this amount. (California Civil Code Section 2987(e).)

14. California Civil Code Section 2987(c)

15. California Civil Code Section 2987(d)(1).

16. California Civil Code Section 2987(d)(3).

17. California Civil Code Section 2987(d).

18. California Civil Code Section 2987(d)(4).

19. California Penal Code Sections 570-573, Civil Code Section 3343.5.

20. California Civil Code Section 2987(a).

21. See Endnote 5.

22. California Civil Code Section 2985.8(j). See page 15 for the text of the "GAP liability notice."

23. "Auto Leasing: Is It Good for Consumers?" in At Home With Consumers, Direct Selling Education Foundation, December, 1996.

24. "Should You Lease Your Next Car?" Consumer Reports, December 1997.

25. Because of the manner in which other components of the lease may be calculated, the percentage may not necessarily measure the overall cost of financing the lease. (See 12 Code of Federal Regulations Section 213.4(s); 61 Federal Register 52246, 52254-52255 (Oct. 7, 1996).)

26. California Vehicle Leasing Act, Civil Code sections 2985.7 to 2990; federal Consumer Leasing Act, 15 United States Code, sections 1667 to 1667e; Consumer Leasing Act regulations, 12 Code of Federal Regulations Part 213 ("Regulation M"). These laws cover leases of vehicles with terms of more than four months for personal, family or household purposes. Federal law does not cover leases where the total contractual obligation is more than $25,000.

27. 12 Code of Federal Regulations Part 213 ("Regulation M").

28. 12 Code of Federal Regulations sections 213.3, 213.4.

29. California Civil Code section 2985.8(d).

30. California Civil Code section 2985.8(g).

31. California Civil Code sections 2985.8(g),(h).

32. California Civil Code section 2986.4.

33. California Civil Code section 2985.8(e).

34. California Civil Code section 2985.8(c)(4); see 15 United States Code section 1667a(2), 12 Code of Federal Regulations section 213.4(b).

35. California Civil Code section 2986.13(a).

36. California Civil Code section 2985.8(f).

37. California Civil Code section 2986.13(b).

38. California Civil Code section 2988.7.

39. California Civil Code section 2988.7.

40. California Civil Code section 2988.5. See this section for limitations and exceptions (for example, certain errors may be correctable and certain bona fide errors may not give rise to liability).

41. 15 United States Code section 1640(a). See this section for limitations and exceptions (for example, certain errors may be correctable and certain bona fide errors may not give rise to liability).

42. California Civil Code section 2989.

Chart 5: Example of Calculation of Early Purchase/Trade-in Price

Early purchase/trade-in at month 12 of lease transaction described at I.E. (pages 4-5) and in sample lease (pages 15-16)

Depreciation amounts accrued through month 12 (taken from Chart 6, page 14):

$ 324.01 (mo. 1 depreciation)	+ 328.51 (mo. 5 depreciation)	+333.07 (mo. 9 depreciation)
+ 325.14 (mo. 2 depreciation)	+ 329.65 (mo. 6 depreciation)	+ 334.22 (mo. 10 depreciation)
+ 326.26 (mo.3 depreciation)	+ 330.78 (mo. 7 depreciation)	+ 335.37 (mo. 11 depreciation)

+ 327.38 (mo.4 depreciation) + 331.96 (mo. 8 depreciation) + 336.53 (mo.12 depreciation)

Total depreciation accrued:	$ 3,962.88	
Early purchase/trade-in price:	$19,515	**adjusted capitalized cost**
	- 3,963	**total depreciation accrued**
	$15,552	
	+ delinquent and unpaid payments	
	+ reasonable purchase option fee	
	Total price (plus applicable taxes and incidental charges)	

Federal Consumer Leasing Act Disclosures (Modified for California)

Closed-End Vehicle Lease Contract*

Date____________________

Lessor(s)______________________________ **Lessee(s)**______________________________________

Description of Leased Property

Year	Make	Model	Body Style	Vehicle ID#
1997	Taurus			

You have traded in today the following Vehicle: __________ (Year) __________ (Make) __________ (Model)

Gross Agreed Upon Value of Trade-In Vehicle: $ ____________________

Amount Due at Lease Signing or Delivery	Monthly Payments	Other Charges (not part of your monthly payment)	Total of Payments
(Itemized below)** $ 1,165	Your first monthly payment of $ 390 is due on 1st., followed by 35 payments of $ 390 due on the 1st. of each month. The total of your monthly payment $ 14,045.	Disposition fee (if you do not purchase the vehicle) $ 250 acquisition fee 375 Total $ 625	(The amount you will have paid by the end of the lease) $ 14,670

****Itemization of Amount Due at Lease Signing or Delivery**

Amount Due At Lease Signing or Delivery:

Capitalized cost reduction	$
First monthly payment	390
Refundable security deposit	400
Title fees	
Registration fees	
Acquisition fee	375
Total	$ 1,165

How the Amount Due at Lease Signing or Delivery will be paid:

Net trade-in allowance	$
Rebates and noncash credits	
Amount to be paid in cash	1,165
Total	$ 1,165

Your monthly payment is determined as shown below:

Gross capitalized cost. The agreed upon value of the vehicle ($ 19,514) and any items you pay over the lease term (such as service contracts, insurance, and any outstanding prior credit or lease balance)	$	19,514
Capitalized cost reduction. The amount of any net trade-in allowance, rebate, noncash credit, or cash you pay that reduces the gross capitalized cost	-	0
Adjusted capitalized cost. The amount used in calculating your base monthly payment	=	19,514
Residual value. The value of the vehicle at the end of the lease used in calculating your base monthly payment	-	9,013
Depreciation and any amortized amounts. The amount charged for the vehicle's decline in value through normal use and for other items paid over the lease term	=	10,501
Rent charge. The amount charged in addition to the depreciation and any amortized amounts	+	3,544
Total of base monthly payments. The depreciation and any amortized amounts plus the rent charge	=	14,045
Lease term. The number of months in your lease	÷	36
Base monthly payment	=	390
Monthly sales/use tax	+	30
	+	
Total monthly payment	=$	420

Itemization of Gross Capitalized Cost

Itemization of Gross Capitalized Cost

You will pay for the following items over the Lease Term, as part of your Monthly Payment:

a. Agreed Upon Value of the Vehicle	$	
b. Taxes	+	
c. Initial Title, License and Registration Fees	+	
d. Aggregate Amount for Service Contracts, including Optional Mechanical Breakdown Protection and Maintenance Agreement	+	
e. Aggregate Amount for Credit Life and/or Disability Insurance Premiums	+	
f. Guaranteed Automobile Protection	+	
g. Outstanding Prior Credit or Lease Balance	+	
h. Document Preparation Fee (Not a Government Fee)	+	
i. ____________________	+	
j. Gross Capitalized Cost	=	

Early Termination. You may have to pay a substantial charge if you end this lease early. The charge may be up to several thousand

Excessive Wear and Use. You may be charged for excessive wear based on our standards for normal use [and for mileage in excess of ______ miles per year at the rate of ____________ per mile].

Purchase Option at End of Lease Term. [You have an option to purchase the vehicle at the end of the lease term for $ _______________[and a purchase option fee of $____________].] [You do not have an option to purchase the vehicle at the end of the lease term.]

Other Important Terms. See your lease documents for additional information on early termination, purchase options and maintenance responsibilities, warranties, late and default charges, insurance, and any security interest, if applicable.

Official Fees and Taxes. The total amount you will pay for official and license fees, registration , title, and taxes over the term of your lease, whether included with your monthly payments or assessed otherwise: $ __________________.

Insurance. The following types and amounts of insurance will be acquired in connection with this lease:
____ .

_______ We (lessor) will provide the insurance coverage quoted above for a total premium cost of $ _________________ .

_______ You (lessee) agree to provide insurance coverage in the amount and types indicated above.

Standards for Wear and Use. The following standards are applicable for determining unreasonable or excess wear and use of the leased vehicle:
____

Maintenance.
[You are responsible for the following maintenance and servicing of the leased vehicle:
____] .

[We are responsible for the following maintenance and servicing of the leased vehicle:]
____] .

Warranties. The leased vehicle is subject to the following express warranties:
____ .

Early Termination and Default. (a) You may terminate this lease at any time.

The charge for such early termination is:
____ .

(b) We may terminate this lease before the end of the lease term under the following conditions:
____ .

Upon such termination we shall be entitled to the following charge(s) for:
____ .

(c) If you disagree with the realized value we assign to the vehicle, you may obtain, at your own expense, from an independent third party agreeable to both of us, a professional appraisal of the value of the leased vehicle. The appraised value shall then be used as the realized value in determining the amount you owe for early termination.
____

Late Payments. The charge for late payments is: ____ .

Option to Purchase Leased Property Prior to the End of the Lease. You have an option to purchase the leased vehicle prior to the end of the term. The price will be [$___________________] [the method of determining the price].

Notice: You have the right to return the vehicle, and receive a refund of any payments made if the credit application is not approved, unless non-approval results from an incomplete application or from incorrect information provided by you.

Notice: (1) Do not sign this lease before you read it or if it contains any blank spaces to be filled in: (2) You are entitled to a completely filled in copy of this lease: (3) Warning ----- Unless a charge is included in this lease for public liability or property damage insurance, payment for that coverage is not provided by this lease.

Lessee's Signature	**Date**	**Lessor's Signature**	**Date**